



BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

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CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF
CITIZENS UTILITIES COMPANY FOR
APPROVAL OF ITS PLAN FOR STRANDED
COST RECOVERY.

DOCKET NO. E-01032C-98-0474

IN THE MATTER OF THE FILING BY
CITIZENS UTILITIES COMPANY OF
UNBUNDLED AND STANDARD OFFER
SERVICE TARIFFS PURSUANT TO A.A.C.
R14-2-1606.

DOCKET NO. E-01032C-97-0774

IN THE MATTER OF COMPETITION IN
THE PROVISIONS OF ELECTRIC
SERVICES THROUGHOUT THE STATE OF
ARIZONA.

DOCKET NO. RE-0000C-94-0165

**CITIZENS UTILITIES
COMPANY'S STANDARD OFFER
AND UNBUNDLED SERVICE
TARIFFS**

Citizens Utilities Company hereby provides Notice of Filing Rebuttal
Testimony in regards to Unbundled and Standard Offer Service Tariffs for Sean R.
Breen in the above-referenced docket.

RESPECTFULLY SUBMITTED on July 28, 1999.

Craig A. Marks

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21 Service List for RE-00000C-94-0165

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1 **INTRODUCTION**

2 Q. Please state your name and business address.

3 A. My name is Sean R. Breen. My business address is Citizens Utilities
4 Company, 1300 South Yale Street, Flagstaff, Arizona.

5
6 Q. Are you the same Sean R. Breen who testified previously in this case?

7 A. Yes, I am.

8
9 Q. What is the purpose of your rebuttal testimony?

10 A. My rebuttal testimony responds to testimony addressing Citizens' positions
11 submitted by Richard La Capra, on behalf of the Arizona Corporation
12 Commission Staff; Richard Rosen, on behalf of the Residential Utility
13 Consumer Office; and Betty Pruitt, on behalf of the Arizona Community
14 Action Association.

15
16 **TESTIMONY OF RICHARD LA CAPRA**

17
18 Q. Please summarize Mr. La Capra's testimony as it relates to Citizens'
19 proposals for electric competition.

20 A. Mr. La Capra set forth a number of principles that Staff believes are
21 necessary to foster the development of a competitive electric services
22 market and provides his assessment of whether Citizens' proposals are
23 consistent with these principles. He also addresses a number of "other
24 issues" raised by my direct testimony.

25
26 Q. Does Mr. La Capra conclude that certain aspects of Citizens' proposals are
27 consistent with Staff's electric competition principles.

1 A. Yes, he does. In summary, he concludes that Citizens' proposals ensure
2 that:

- 3 ▪ All potential suppliers have access to customers;
- 4 ▪ Citizens will not have any incentive to attempt to hinder supplier
5 or customer access to the wires;
- 6 ▪ Customers have the opportunity to purchase electric services
7 from a supplier of their choice;
- 8 ▪ Customers are informed of what they pay for each (non-CTC)
9 functional component of rates so they can compare different
10 providers;
- 11 ▪ There is little opportunity or motivation for Citizens to shift costs
12 from unregulated to regulated functions;
- 13 ▪ Stranded costs have been significantly reduced; and
- 14 ▪ Existing ratepayers will (apparently) receive significant savings
15 as a result of Citizens' stranded cost mitigation efforts.

16
17 Q. Are there aspects of Citizens' proposals that Mr. La Capra believes are at
18 odds with the Staff's electric competition principles?

19 A. Yes, there are three areas where Mr. La Capra expresses concern about
20 Citizens' proposals:

- 21 ▪ Generation market power relative to Citizens' must-run Valencia
22 facilities;
- 23 ▪ The ability of customers to know in advance how much bills will
24 be reduced if alternative suppliers are chosen; and
- 25 ▪ Citizens' "Enhanced Divestiture" proposal.

1 Q. Does Citizens really have the potential to exert generation market power?

2 A. No. Mr. La Capra asserts that the pricing or availability of Citizens'
3 generation may disadvantage alternative suppliers. As explained in various
4 of our filings, the Valencia facilities (Citizens' only generation) are operated
5 solely for backup and voltage support to the single radial transmission line
6 serving Citizens' Santa Cruz County territory and are currently the only
7 backup source in the area. Further, their annual operation is strictly limited
8 by the terms of their air quality permit. The Valencia facilities pose no
9 threat to competition.

10

11 Q. Hasn't Staff previously addressed the issue of the Valencia generation?

12 A. Yes. Staff recognized the critical need for the Valencia facilities to support
13 distribution reliability. Staff's December 22, 1998, proposed order on
14 Citizens' unbundled and standard offer tariffs, stated:

15 "The costs of Citizens' Valencia facilities shall be reflected
16 in the revenue requirements underlying the rates for
17 distribution service. If the Valencia facilities are no longer
18 needed to support local transmission reliability, or other
19 significant operating changes occur, Citizens will meet with
20 Staff to determine if and how its rates should be revised to
21 account for the changes that have occurred."

22 Nothing has changed to affect that conclusion.

23

24 Q. Should Mr. La Capra be concerned about the ability of customers to know in
25 advance how much bills will be reduced if alternative suppliers are chosen?

26 A. No. Mr. La Capra's concern centers on the fact that Citizens' CTC has not
27 yet been defined. Citizens' filed unbundled and standard offer tariffs list the
28 charges under its CTC as "to be determined" because of the uncertainty
29 about the manner in which the Commission would approve its proposed

1 stranded cost recovery mechanisms. Once a definitive order has been
2 issued, the CTC charges will be determined and itemized in Citizens' tariffs.
3 (Under Citizens' proposed standard offer tariffs, both the charge for
4 generation and the CTC are itemized.) Citizens' unbundled tariff charges
5 are identical to its standard offer charges, except there is no charge for
6 generation. Customer savings will be clearly revealed.

7
8 Q. Is Mr. La Capra correct in characterizing Citizens' "Enhanced Divestiture"
9 proposal as simply "responding to basic Commission directives."

10 A. Not at all. Citizens' Enhanced Divestiture proposal is an innovative
11 alternative, where the Company would not only divest its generation assets
12 to value its stranded costs, but would also voluntarily put out to bid the
13 generation-related, obligation-to-serve components of its Certificate of
14 Convenience and Necessity. Nowhere in the competition rules or any of its
15 orders has the Commission suggested that the implementation of electric
16 competition require utilities to relinquish their rights and obligations to
17 serve standard-offer generation customers. Citizens made this offer as a
18 means to mitigate the total level of its stranded cost, recognizing that the
19 ability to gain a significant foothold in the Arizona electric market may in
20 fact be an attractive prospect to potential bidders. Citizens proposed that
21 the proceeds from the voluntary sale be treated in a manner similar to
22 long-standing precedent concerning sales of rate-based utility assets,
23 where the above-book-value proceeds are split evenly between ratepayers
24 and stockholders. Citizens continues to support its Enhanced Divestiture
25 proposal.

1 Q. What are the "other issues" Mr. La Capra raises about Citizens' proposals?

2 A. Mr. La Capra takes exception with six other areas of Citizens' proposals:

- 3 ▪ The Metering and Billing Deferral Account;
- 4 ▪ The Competitive Transition Deferral Account;
- 5 ▪ Citizens' proposal to defer divestiture of the APS contract;
- 6 ▪ The effect of APS contract renegotiations;
- 7 ▪ The proposed interim CTC; and
- 8 ▪ The interaction between the Purchased Power and Fuel
9 Adjustment Clause ("PPFAC") and the CTC.

10

11 Q. Why does Mr. La Capra oppose Citizens' proposal to establish a Metering
12 and Billing Deferral Account to track costs stranded by competition?

13 A. Mr. La Capra presents a host of reasons for not allowing recovery of
14 Metering and Billing stranded costs. These reasons could just as easily
15 serve to thwart recovery of stranded generation costs, a proposition
16 already rejected by the Commission. Although La Capra supports
17 resolution of "disputes over stranded costs" as a requisite to effective
18 electric competition, he now appears, when it comes to non-generation
19 assets, to reject stranded recovery outright. The introduction of
20 competition to metering and billing services, that have previously been
21 provided through a price-regulated monopoly, potentially strands costs in
22 exactly the same way as does the introduction of competition to generation.
23 The very same arguments for recovery of stranded costs for generation
24 apply equally to other utility activities opened to competition. The
25 Commission has ruled unambiguously that utilities should be allowed a
26 reasonable opportunity to recover prudently incurred stranded costs; no
27 exception should be made for metering and billing.

28

29

1 Q. What are Mr. La Capra's issues with Citizens' proposed Competitive
2 Transition Deferral Account ("CTDA")?

3 A. While Mr. La Capra supports allowing Citizens to establish the CTDA, he
4 opposes "automatic" collection of additional transition costs through the
5 CTC.

6
7 Q. Does Citizens propose "automatic" cost recovery for its CTDA?

8 A. No. Recovery would occur only after review of incurred or projected costs,
9 and costs would not be flowed through the CTC until approved by the
10 Commission.

11
12 Q. In what situations would additional transition costs be covered by existing
13 revenue streams as Mr. La Capra suggests?

14 A. By definition, this will never occur. The costs included in my testimony are
15 incremental costs for new functions that are not now performed and which
16 will require new investment and expense to undertake.

17
18 Q. Could Citizens earn more than its authorized rate of return if it recovered
19 transition costs?

20 A. Mr. La Capra suggests that this could result from offsetting changes in costs
21 or revenues in other areas, which could allow Citizens to earn more than an
22 appropriate rate of return. Alternatively, he suggests that if the Company
23 didn't earn its authorized return it could always file a rate case. Mr. La
24 Capra has taken a classic "Heads I win, tails you lose" position. He is in
25 essence suggesting that the Commission today establish rates below the
26 cost of service because there might be some offsetting changes in costs or
27 revenues in the future. Further, he suggests that Citizens just "file a rate
28

1 case" if it finds itself under-earning, knowing full well that the impacts of
2 stranded metering/billing and transition costs would likely never rise to the
3 level of justifying a full rate case. Further, the prohibition against
4 retroactive ratemaking would prohibit recovery of past unrecovered
5 transition costs. Mr. La Capra's suggestion would ignore lawful principles of
6 rate-making.

7
8 Q. With regard to the APS contract negotiations, is it true, as Mr. La Capra
9 suggests, that Citizens' PPFAC will not return the negotiated retroactive rate
10 reductions to customers?

11 A. No. All retroactive refunds will flow through Citizens' PPFAC bank and
12 accrue fully to the benefit of customers.

13
14 Q. Is it true that Citizens has not provided information as to how much
15 generation costs have been reduced?

16 A. No. Both in my direct testimony and in response to data requests from
17 Staff, Citizens has quantified the cost reductions it expects from the APS
18 contract renegotiations. Citizens expects to file in the near future an
19 adjustor mechanism to its PPFAC that will pass these savings directly to
20 customers.

21
22 Q. Is it true that Citizens needs to return to customers the "significant
23 payment" made by Griffith Energy?

24 A. No. The payment from Griffith Energy is a partial offset to capital
25 expenditures incurred since the conclusion of Citizens' last rate case. These
26 expenditures were never included in rate base, therefore, the underlying
27
28
29

1 net investments are not reflected in current rates. No payment need be
2 returned.

3
4 Q. Does Mr. La Capra oppose spreading the collection of stranded costs across
5 all customers?

6 A. Yes, he does.

7
8 Q. Why is Citizens making a proposal to do so?

9 A. Citizens proposed to collect stranded costs from all customers because the
10 current version of the competition rules states (R14-2-1607(F)): "A
11 Competition Transition Charge may be assessed on all retail customers
12 based on the amount of generation purchased from any supplier."

13
14 Q. Is it true that, under Citizens' proposed CTC mechanism, standard offer
15 customers would pay both over-market embedded generation costs and the
16 net revenue lost from departing customers taking competitive power?

17 A. Yes. However, it is also true that the magnitude of the portion of the CTC
18 associated with lost net generation revenues, when spread over all
19 customers, is likely to be small in the early stages of competition. Citizens
20 believes that the effect of generation cost reductions in the APS contract
21 will largely, if not completely, offset bill increases due to the generation
22 CTC.

23
24 Q. Why is this so?

25 A. The first year of APS contract rate reductions will reduce generation costs
26 by approximately \$3 million. Citizens' current energy sales volume is
27 approximately 1,000,000 MWh. Consequently the contract savings are
28
29

1 approximately \$3/MWh. The high estimate of the difference between
2 generation revenues and the marginal cost of generation is \$20/MWh.
3 Thus, under Citizens' proposal, first-year sales loss would have to exceed
4 15% ($\$3/\20) for generation CTC charges to exceed contract savings – a
5 very unlikely event.
6

7 Q. Is there a method of CTC recovery that would avoid the need for standard
8 offer customers to pay both above-market generation costs and the net
9 revenues lost when customers depart Citizens' system?

10 A. Yes, there is. Citizens could adopt a "shopping credit" approach, as now
11 proposed in the APS and Tucson Electric Power settlements, where the
12 departing customers are given a generation credit reflective of the
13 competitive retail market price for power. Under this approach stranded
14 costs (the difference between Citizens' average generation cost and market
15 price) are the same for all load.
16

17 Q. Why did Citizens not adopt this approach in its filing?

18 A. Citizens did not adopt a shopping-credit approach because its interpretation
19 of the competition rules is that the Commission is seeking: 1) to unbundle
20 rates in a manner that provides "credit" to customers taking competitive
21 services for the full embedded cost of generation; and 2) a CTC that
22 reflects only those costs that are actually stranded by competition.
23

24 Q. What do you mean by "costs that are actually stranded by competition?"

25 A. By "actually stranded" I am referring to the fact that, until some customer
26 leaves the system, technically there are no stranded costs.
27
28
29

1 Q. Is it true, as Mr. La Capra states, that for a utility that does not own
2 generation, stranded costs are the "difference between embedded revenues
3 requirements associated with their contracts and the market value of the
4 same amount of power."

5 A. No, not in a practical sense. Mr. La Capra's definition of stranded costs
6 here implies that the power in question could in fact be sold on the open
7 market. In Citizens' case, its contract with APS does not allow for re-sale of
8 power "freed up" by customers purchasing electricity competitively.
9 Therefore, what becomes "stranded" by competitive sales loss is not so
10 much related to what the power could be sold for competitively, as it is to
11 what costs are left unrecoverable as a result of the loss of sales. In
12 Citizens' case, the amount "actually stranded" is equal to the difference
13 between the average cost of generation embedded in the rates it would
14 have been paid and its avoided costs from not having to serve the sales.
15 Citizens' filing seeks approval from the Commission to recover the costs
16 that are actually stranded and to spread these across all customers. Any
17 similarity between this amount and the amount consistent with Mr. La
18 Capra's definition would be purely coincidental.

19
20 Q. Would Citizens oppose adoption of a "shopping credit" approach to stranded
21 cost recovery?

22 A. No, not as long as the CTC mechanism ensured full recovery of costs
23 actually stranded by competition.

24
25 Q. How could this be accomplished?

26 A. To ensure full stranded cost recovery, there would have to be a
27 reconciliation process put in place that periodically calculated the difference
28

1 between Citizens' CTC recoveries and the amounts actually stranded, as I
2 have defined them, and the ability to adjust the forward-going CTC to
3 account for these differences.

4
5 Q. Is Mr. La Capra correct in stating that there may be interactions between
6 Citizens' CTC mechanism as proposed and the Company's PPFAC?

7 A. Yes. The calculation of PPFAC bank adjustments must explicitly account for
8 CTC recoveries in order to accurately reflect only the differences between
9 fuel/purchased power costs and the base charges embedded in rates.

10
11 Q. Do you believe it is necessary for Citizens to re-file its tariffs to better
12 define the energy adjustment and the CTC?

13 A. No. However, Citizens does not oppose filing a detailed explanation of its
14 calculation methods in its compliance filing in these proceedings.

15
16 **TESTIMONY OF RICHARD ROSEN**

17
18 Q. Are Citizens and RUCO engaged in settlement discussions on the points
19 covered in Dr. Rosen's testimony?

20 A. Yes, RUCO invited us to join with them to discuss and hopefully resolve,
21 open issues. I share Dr. Rosen's optimism that these discussions will lead a
22 settlement. We would hope for similar discussions and results with Staff.

23
24 Q. What is the purpose of your rebuttal in relation to the concerns about
25 Citizens' stranded cost recovery plans raised in Dr. Rosen's testimony?

1 A. The purpose of my rebuttal testimony is to make Citizens' current positions
2 on these issues a matter of record for use in the event settlement
3 discussions break down.
4

5 Q. Do you share Dr. Rosen's concern that take-or-pay provisions of Schedule A
6 of the APS contract, together with the inability to re-sell power, could
7 significantly add to stranded costs?

8 A. Yes and no. This is because the take-or-pay provisions of Schedule A only
9 apply to the first 100 MW of Citizens' power requirements, and Citizens
10 peak load requirements exceed 250 MW. Therefore, significant load
11 reductions must occur before these impacts on stranded costs become
12 material. Citizens has proposed that the Commission consider delaying
13 divestiture of its contracts, at least until it is clear that the costs and risks
14 of divestiture are justified. The impacts referred to here by Dr. Rosen
15 would only become a real concern after significant levels of sales loss.
16 Further, any impacts would likely be small compared to price reductions
17 resulting from the APS contract renegotiation.
18

19 Q. Would re-negotiation of the APS contract to allow re-sale of power freed-up
20 by competition alleviate this problem, as Dr. Rosen states?

21 A. Yes, it would. Citizens has and will continue to discuss alternatives in this
22 regard with APS.
23

24 Q. Does Citizens support Dr. Rosen's proposal to separately calculate stranded
25 costs for each rate class, reflecting the amount of participation in direct
26 access by class.
27
28
29

1 A. Yes, it does. However, implementation would require a waiver of the
2 competition rules that specify that stranded costs are to be recovered "in a
3 manner consistent with the specific company's current rate treatment of the
4 stranded asset." For Citizens, this translates to a stranded cost allocation
5 generally consistent with the allocation of generation costs in current rates.
6 Citizens agrees that it is likely that commercial and industrial customers will
7 be the dominant participants in direct access. Therefore, the allocation of
8 stranded costs in proportion to direct access participation would likely result
9 in greater allocations of stranded costs to these customer classes than if
10 Citizens were to allocate these costs in the same manner as generation.

11
12 Q. Does Citizens continue to support stranded cost recovery based on each
13 customer's historical use of electricity?

14 A. Yes. Citizens continues to believe this is the proper manner to allocate
15 stranded costs to customers, because stranded costs result from historical
16 decisions about generation investments, which in turn were based on load
17 forecasts under historical (now incorrect) assumptions. If stranded cost
18 recovery is based on prospective usage, future consumption decisions will
19 be influenced by relics from the past. Consequently, the marginal price of
20 power to customers will not reflect the true marginal cost.

21
22 Q. Does Citizens continue to support flat monthly fees for stranded cost
23 recovery.

24 A. Yes. Again, the cause of stranded costs are decisions made under historical
25 assumptions. Future decisions about consumption should not be unduly
26 influenced by past decisions. Implementing flat fees for stranded cost
27 recovery is a sound way to avoid such influence.

1 Q. Would implementation of a stranded recovery mechanism that was based
2 on volumetric charges and future consumption unduly impact Citizens'
3 ability to recover its stranded costs?

4 A. No. Citizens has proposed the historical usage/flat fee approach not for
5 reasons of assuring cost recovery, but because it believes this approach will
6 result in less economic distortion to future electricity purchase decisions.
7

8 Q. What has Dr. Rosen proposed relative to recovery of Citizens' deferred DSM
9 costs?

10 A. He has proposed continued deferral of these costs on the grounds that the
11 ACC has approved carrying charges for these costs.
12

13 Q. What is wrong with this suggestion?

14 A. Dr. Rosen's suggestions appears to ignore the larger picture of what is
15 occurring as the industry transitions from a regulatory environment to a
16 market environment. Regulatory assets, like Citizens' deferred DSM costs,
17 are relics of the fully-regulated industry. Without clear evidence of the
18 regulatory intent to recovery, the ability for utilities to continue to carry
19 these assets on their books, under generally-accepted accounting
20 principles, would become highly questionable after the transition to
21 competition. Understanding this, the Commission, in Decision No. 60977
22 (6/28/98) in this docket, provided for assured recovery of regulatory
23 assets. Dr. Rosen is wrong when he states that "it seems inappropriate to
24 include purported DSM cost amounts at this time."
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1 Q. Does Dr. Rosen express concern about Citizens' proposed recovery of
2 stranded costs associated with billing and metering?

3 A. Yes. He suggests that competition should be structured in a way that
4 avoids stranded billing and metering, by for instance, offering billing and
5 metering services to ESPs.

6
7 Q. Could Citizens offer billing and metering services to ESPs under the current
8 competition rules?

9 A. No. Citizens' current business plans do not include establishing a
10 competitive affiliate to offer and compete for metering and billing services,
11 or any competitive electric services, for that matter. Rule section R14-2-
12 1615(B) unambiguously states: "Beginning January 1, 2001, an Affected
13 Utility or Utility Distribution Company shall not provide Competitive
14 Services as defined in R14-2-1601." Since "Competitive Services" include
15 billing and metering, the current rules effectively preclude Citizens from
16 offering billing and metering services to ESPs. Citizens is thus faced with
17 the need to recover costs stranded by opening billing and metering to
18 competition and has set forth a sound and reasonable means for doing so.
19 Again, the Commission should disregard Dr. Rosen's testimony on this
20 matter.

21
22 Q. Does Dr. Rosen comment on Citizens' proposal for recovering electric
23 competition transition costs?

24 A. Yes, he does. He suggests that transition costs are not stranded costs
25 because they are not generation-related, and therefore should not be
26 recovered as such.

27

28

29

1 Q. Is Dr. Rosen correct that "transition costs" are not stranded costs?

2 A. No. Referring once again to the competition rules, the definition of
3 "Stranded Costs" in R-14-2-1601 includes: "Other transition and
4 restructuring costs as approved by the Commission as part of the Affected
5 Utility's Stranded Cost determination pursuant to R14-2-1607." Consistent
6 with this direction, Citizens has included its transition costs and a proposed
7 mechanism for their recovery in its filing. Clearly, there costs would not be
8 incurred but for the introduction of competition. Once again, the
9 Commission should disregard Dr. Rosen's testimony on this subject.

10

11 Q. Dr. Rosen states that Citizens' current estimate of stranded costs seems to
12 involve two flaws. Do you agree with his assessment?

13 A. I do not disagree in concept with Dr. Rosen, however, most likely the
14 "flaws" are not material. First, I have not seen the results of the updated
15 Stone & Webster analysis of the regional electricity prices, particularly for
16 delivery into Citizens' service areas. If those results are made available to
17 Citizens, we will review them for possible inclusion in our stranded cost
18 calculations. Second, Dr. Rosen also opines that Citizens did not include
19 the last year of the APS-Citizens contract in our analysis, and that it would
20 have a downward effect on our estimate. Citizens did not in fact include
21 the last year of the APS Schedule A contract in the analysis, primarily
22 because the contract expires in mid-year. However, it was also recognized
23 that the discounted present value of a part-year impact twelve years into
24 the future would not have a material effect on the calculation.

25

26

27

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29

1 Q. Do you disagree with Dr. Rosen that the retail shopping credit for
2 residential customers should be based on the expected retail market
3 generation price?

4 A. No. In the event that the Commission determines that the "shopping
5 credit" approach for stranded recovery is appropriate for Citizens, it does
6 not object to having the residential credit so based.
7

8 **TESTIMONY OF BETTY PRUITT**
9

10 Q. Are the rate design changes alluded to in Ms. Pruitt's testimony a part of
11 Citizens' proposed unbundled rates now before the Commission?

12 A. No. The matters Ms. Pruitt refers to are elements of the December 1998
13 Stipulation with Staff. As part of that stipulation, Citizens would make a
14 separate filing with the Commission to implement the proposed rate design
15 changes. Citizens has not made that filing and, therefore, will not address
16 Ms. Pruitt's concerns in this proceeding.
17

18 Q. Does this conclude your testimony?

19 A. Yes.
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